SUPREME COURT, U.S.

Supreme Court, U.S.
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IN THE

Supreme Court of the United States

OCTOBER TERM, 1970

No. 1652

FIDELITY AND CASUALTY COMPANY OF NEW YORK, ET AL.,

Petitioners,

versus

THE NATIONAL BANK OF COMMERCE IN NEW ORLEANS,

Respondent.

PETITION FOR CERTIORARI TO REVIEW JUDGMENT, OPINION, AND DECREE OF THE FIFTH CIRCUIT IN NO. 29822 OF THE DOCKET OF SAID COURT

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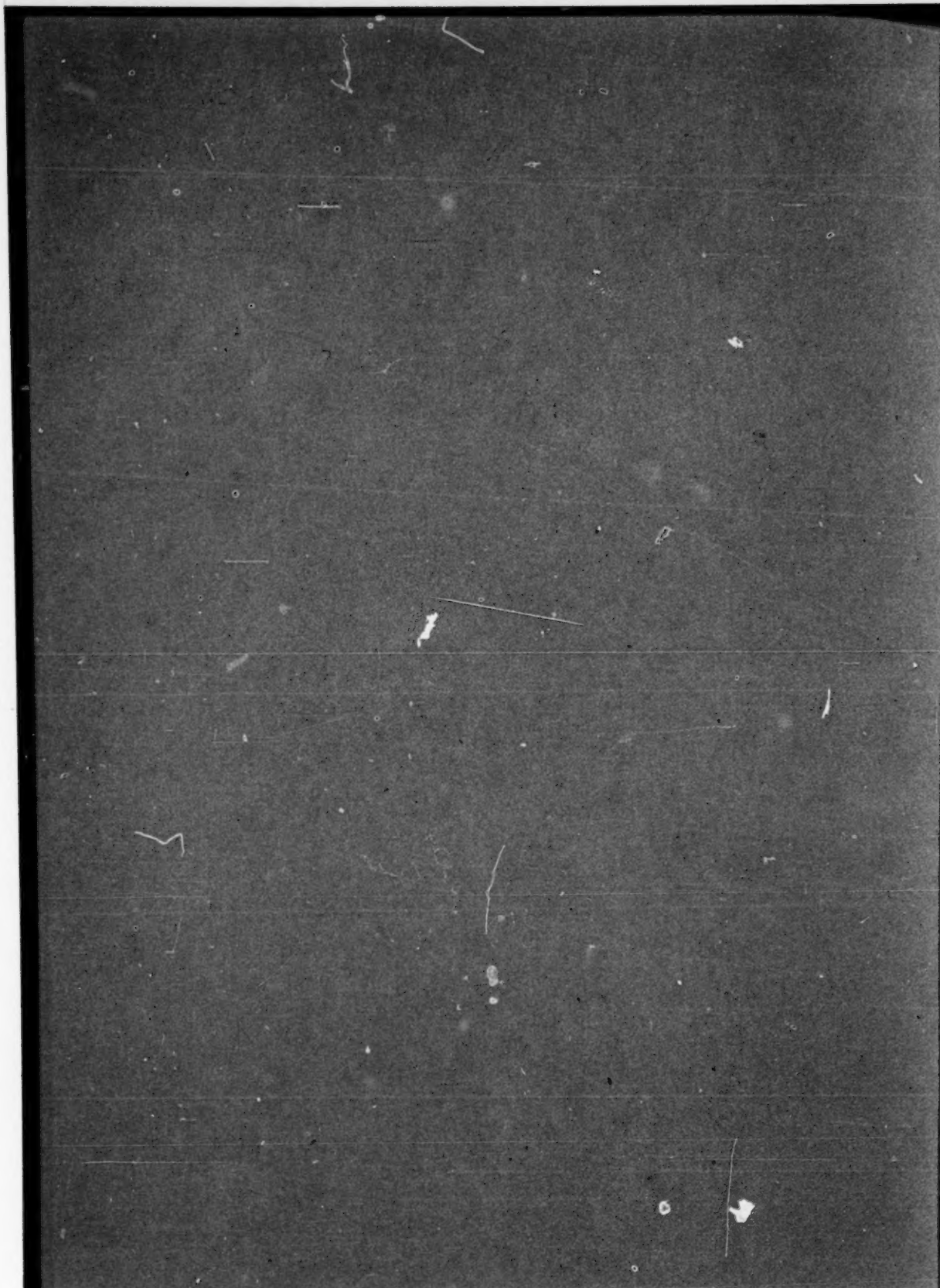


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TO THE HONORABLE CHIEF JUSTICE AND ASSOCIATE JUSTICES OF THE SUPREME COURT OF THE UNITED STATES:

Petitioners, Fidelity and Casualty Company of New York, The Travelers Indemnity Company, and Fireman's Fund Insurance Company, pray that a writ of certiorari issue herein to the United States Court of Appeals for the Fifth Circuit to review the opinion and judgment of said Court rendered on January 29, 1971, in the matter entitled: The National Bank of Commerce in New Orleans, Plaintiff-Appellee, versus Fi-

delity and Casualty Company of New York, The Travelers Indemnity Company, Fireman's Fund Insurance Company, Defendants-Appellants Cross Appellees, Hughes-Walsh Company, Inc. and Clifford E. Hughes, Intervenors-Cross Appellants, No. 29,922. There was no application for rehearing.

CITATIONS TO THE OPINION BELOW

The opinion below is as yet unreported but same is presented herein in the Appendix, Appendix A. The District Court opinion appears in 312. F.S. 71.

JURISDICTIONAL STATEMENT

The opinion of the Fifth Circuit Court of Appeals was rendered on January 29th, 1971.

Jurisdiction of this Court is invoked under 28 U.S.C. Sec. 1254(1).

The judgment complained of is a final judgment.

QUESTIONS PRESENTED

1. In determining coverage under a policy of insurance issued to a bank under a section relating to losses due to obtaining property through "false pretenses" can there be any recovery on behalf of the insured bank, where, from the general circumstances, it is clear that there was no intent to defraud;

2. Whether the loss to the bank, under the circumstances set forth above, was actually a "loan" by the bank, which type of loss is expressly excluded from coverage:

3. Whether or not the Court was justified in ignoring the plain provisions of Louisiana law as to the propriety of allowing attorney fees as a penalty.

STATUTES INVOLVED

1. The Due Process Clause of the Fourth Amendment to the Constitution of the United States;

2. Louisiana Revised Statutes 22:658;

3. Louisiana Revised Statutes 9:3902

STATEMENT OF THE CASE

This application for certiorari involves, primarily, the proper interpretation of a type of insurance issued to banks, commonly referred to as a "Banker's Blanket Bond" policy. There is a conflict between the decision of the Fifth Circuit herein complained of and those of other jurisdictions, hence this is a matter of national interest.

More specifically, the principal issue here was whether a so called "check kiting" scheme was within the policy coverage.

Hughes Walsh Company, Inc. is the alter ego of Clifford E. Hughes, an electrical contractor who does a substantial amount of business in both Texas and Louisiana. He was also a director of the Dallas bank involved in the alleged "check kiting" scheme. Hughes is the purported villain in the N.B.C. script. He is supposed to have resorted to a "check kiting scheme" involving his own bank, a bank which, as the record shows, had honored his overdrafts as a regular occurrence, sometimes for as much as one hundred thousand dollars.

Among other defenses, the insurers here urge that there was utterly lacking the element of intent to defraud which has been presented in all reported cases where a check manipulation scheme has been found by the Courts to be covered by this bond provision.

As will be noted in more detail in argument below, factors which indicate that there was no "kiting" system involved at all are:

a) That Hughes was and had been for several years a director of the Dallas bank involved in the alleged scheme;

b) That said Dallas bank had repeatedly honored overdrafts in his account with them, on several occasions for substantially more than the sum involved here;

c) That said Dallas bank, of which Hughes was a director, had a substantial loan account with him and his various companies;

d) That accounts receivable more than sufficient to cover the resulting overdraft on the Dallas bank were virtually "on the way" to the Dallas bank and only failed to reach the Hughes Company account because a large creditor in a lawsuit issued a garnishment and seized his accounts receivable;

e) That a principal officer of the Dallas bank stated that the only reason he did not honor the overdraft check involved here was that he learned of the garnishment proceedings which would cut off the deposit of funds to the Hughes account sufficient to cover the overdraft; and

f) That shortly after the check was dishonored and returned, Hughes made an offer to appellee bank for full restitution in the form of a note for the full amount secured by adequate real estate security.

The Bond Coverage Provision

The claim of respondent, N. B. C. for recovery, is predicated upon Clause B of the bond, which provides:

"ON PREMISES

(B) Any loss of Property through robbery, burglary, common-law or statutory larceny, theft, false pretenses, hold-up, misplacement, mysterious unexplainable disappearance, damage thereto or destruction thereof, whether effected with or without violence or with or without negligence on the part of any of the

Employees, and any loss of subscription, conversion, redemption or deposit privileges through the misplacement or loss of Property, while the Property is (or is supposed to be) lodged or deposited within any offices or premises located anywhere, except in an office hereinafter excluded or in the mail or with a carrier for hire, other than an armored motor vehicle company, for the purpose of transportation."

THE FACTS

Commencing on or about August 15, 1967, Hughes-Walsh had a checking account with the N. B. C., and Hughes individually, as President of Hughes-Walsh, was authorized to sign checks on said account.

On September 12, 1968, there was deposited in said Hughes-Walsh account in the N. B. C., through the United States mail, a check of that corporation dated September 10, 1968, drawn on the South Oak Cliff State Bank of Dallas, in the sum of $87,450.00, against the Hughes-Walsh account in said bank and signed by Hughes as President of Hughes-Walsh. This check was accompanied by a deposit slip of Hughes-Walsh and credit for the amount of said check was entered in the Hughes-Walsh account in the N. B. C. The South Oak Cliff State Bank of Dallas is the bank earlier referred to of which Hughes was a director and which frequently loaned him substantial sums and habitually honored overdrafts in excess of the amount involved here.

Said check was sent to the Federal Reserve Bank in Dallas and on September 18, 1968 (eight days after the date of the check and six days after its receipt in New Orleans for deposit), the N. B. C. was notified that the South Oak Cliff State Bank refused to honor the check and it was being returned "N.S.F."

Meanwhile, on September 13, 1968, a check of Hughes-Walsh signed by Hughes and another officer, dated September 10, 1968, in the amount of $87,500.00 and drawn on the plaintiff bank, was paid by plaintiff bank, N. B. C. It was deposited in the Dallas Bank on September 11 to the Hughes-Walsh account.

On September 24, 1968, the N. B. C. made demand upon Hughes-Walsh and Hughes individually for the sum of $87,500.00, the amount of the check which the Dallas Bank had refused to honor when it learned of the garnishment proceedings in Texas which had blocked the flow of receivables to the Hughes-Walsh account.

Thereafter, on October 16, 1968, the N. B. C. made demand upon appellant, Fidelity and Deposit Company of Maryland, for indemnity under the blanket bond, less the $5,000.00 deductible provided therein. (App. 27).

The Fatal Garnishment

As noted hereinafter, the Dallas bank, of which Hughes was a director, frequently honored overdrafts in the Hughes-Walsh account, sometimes for amounts

in excess of the sum involved here. This was made very clear from the testimony of Mr. Gerald C. Clark, executive vice president of the Dallas bank. His depositions in other pending cases were offered in evidence and, at the close of the case he testified "live" as the Court's own witness. (App. 433)

The Offer of Restitution as Showing Lack of Fraudulent Intent

As will be shown below, the trial judge clearly assumes that the bare fact of drawing a check against insufficient funds is, of itself, sufficient to constitute "false pretenses" under this bond coverage. As will be developed hereinafter by reference to the cases, this is absolutely false. But it is perhaps for this reason, i.e., reliance upon a false concept of what constitutes "false pretenses," that the trial Judge makes so shallow an exploration of the factual background. Among the facts which he ignores entirely in his "Findings" is the fact that Hughes made a serious offer of restitution shortly after the check was dishonored.

The entire tenor of the trial Court's findings suggests that Hughes was a sort of fly-by-night operator who was trying to operate on a shoe string basis without sufficient funds. Overlooked entirely are such factors as the extent of his operations, the fact that he had excellent credit with the Dallas bank which frequently honored overdrafts in excess of the amount involved here, loaned him or his companies substantial sums readily and, by the testimony of the executive vice president, would have honored the overdraft here

had not all receivables been tied up by the garnishment suit filed in Texas.

The second of the "Questions Presented" supra, relates to an alternative defense made by the insurer here, namely, that the loss to the bank was by virtue of a de facto loan granted by the bank in allowing instant credit to the depositors account whenever checks were deposited. This was done in conformity with a clause on the deposit slips of the National Bank of Commerce, appellee.

The policy clause, excluded from coverage:

> "Any loss the result of the complete or partial nonpayment of or default upon any loan made by or obtained from the insured, *whether procured in good faith or through trick, artifice or pretenses, except when covered by Insuring Clause (A) (D) or (E)*" (Emphasis added).

The third of the "Questions" supra, relates to a brand new Federally created interpretation of a Louisiana statute covering the award of penalties for unreasonable delays in payments due by insurers in certain cases. Stated broadly, it is contended here that the Fifth Circuit, with no reasons whatever in its "Per Curiam" opinion has demonstrated a Sphinx-like inscrutability whilst contemplating what the District Court had done in the area of tampering with State substantive law. The Sphinx may smile, but petitioner cannot smile at this obvious deprivation of property

without due process. Although the amount of the penalties imposed is small, the principle is one which runs deep and dangerously from the viewpoint of those who are not yet ready for the States to abdicate all their powers. This Court could never guess, from the Per Curiam below, that so dangerous a principle lies buried in this record. Thus, the grant of certiorari here will enable Your Honors to dig beneath the surface here and readily ascertain that the instant sandpile affords no valid basis for the Sphinxlike smile of the Fifth Circuit in contemplating what has been attempted here quo ad Judge-made state law, by a Federal Court.

REASONS FOR GRANTING THE WRIT

FIRST REASON: In this case both the District Court and the Fifth Circuit have given an interpretation to the coverage of this type of policy which is in conflict with that of every jurisdiction which has been presented with this particular problem. The divergence from the universal rule stated in other jurisdictions lies in the fact that here the Courts below have sanctioned coverage of this type of policy regardless of whether or not there was any actual intent to defraud or actual bad faith on the part of the party depositing the check or checks. This is clear from the language used by the trial judge in his "Findings of Fact and Conclusions of Law" (App. 479 et. seq.)

"III. DID THE LOSS RESULT FROM FALSE PRETENSES?

"The bond covers any loss through "false pretenses." This phrase has been interpreted

by the courts as including losses sustained by a bank through check kiting. By presenting the check to the New Orleans bank, the customer represented that it was drawn against an account with sufficient funds. Since it knew at the time that it did not have enough money to cover the check, the customer was deliberately using a false impression — a "pretense" — so that it could draw on the artificial credit created in the New Orleans bank. That pretense caused the bank to sustain this loss. See Hartford Accident and Indemnity Co. v. Federal Deposit Insurance Corp., 8 Cir. 2953, 204 F.2d 933; Fidelity and Casualty Company v. Bank of Altenburg, 8 Cir. 2954, 216 F.2d 294; United States v. Western Contracting Corporation, 8 Cir. 2965, 341 F.2d 383; United Pacific Insurance Co. v. Idaho First National Bank, 9 Cir. 2967, 378 F.2d 62; Indemnity Insurance Co. v. Pioneer Valley Savings Bank, 8 Cir. 2965, 343 F.2d 634.

"It is argued that these cases are so distinguishable on their facts from the case at bar that their holdings are irrelevant. This is to insist that to apply Palsgraf we must find scales in a depot. In all the cases the courts found that obtaining funds or credit from banks through the knowing circulation of worthless checks amounted to "false pretenses," and that the banks' resultant losses were covered by the Bankers' Blanket Bond. Although the details of the check kiting operations vary from case

> to case, the logic of the opinions is both pertinent and persuasive." (Emphasis added)

But even the most casual analysis of the cited cases will show clearly that they contradict the conclusions of the trial Judge. In fact, they stand for exactly the opposite proposition, namely, that there can be no recovery under this type of coverage absent a showing of actual bad faith over and above the bare fact that the depositor-drawee knew that there were not, at the moment sufficient funds in the account to cover the transaction.

Among the cases cited by the trial Judge as the basis for his rule, the second most dramatically refutes his contention. Thus, in THE FIDELITY AND CASUALTY COMPANY OF NEW YORK v. BANK OF ALTENBURG, 216 F.2d 294 (Eighth Cir. 2954), cited by the trial Judge at App. 480, the Eighth Circuit stated: (at page 302 of 216 F.2d, last paragraph)

> "Check kiting, as practiced here, involves more than the mere use of a check with insufficient funds in the bank to meet it. It involves a series of acts which together constitute a scheme, a studied device, false pretenses built upon a series of false representations designed to lull the banks involved into a feeling of confidence and security." (emphasis added)

The foregoing emphasized language strikes us as being as strong as the English language can make it that mere presentation of a N.S.F. check wherein mo-

mentarily credit has been created by deposit of another check in another bank, is not of itself sufficient to constitute "false pretenses" under this type of bond coverage. In its lengthy opinion, the Eighth Circuit quoted extensively from the facts and these facts depicted the overall atmosphere of fraud involved. A very small bank was the victim in this case, so small, in fact, that the loss of some $28,000.00 put it out of business. The deliberate and fraudulent kiting scheme was long continued, covering some nine or ten months and commenced with the very opening of the account. Thus: (at p. 296 of 216 F.2d, third par.)

> "The record shows that at the very time Schneier opened his account with plaintiff in February 1960, he initiated his check kiting scheme and that it continued regularly thereafter until December 30, 1960." (Emphasis added)

Moreover, in the opinion of the trial Judge (which was adopted with approval by the Eighth Circuit) deliberate misrepresentations to the victim bank were shown. Thus, at page 297, second paragraph, after one of the bank officials began to notice how the scheming depositor always included one very large check along with a lot of little ones, and inquired about this, the Court says the following fraudulent answer was given: (page 297, last par.)

> "Mr. Schneier told me that he was buying a lot of poultry and eggs and livestock, that he was selling that here in St. Louis, collecting

> the money in his name, taking it to Brazeau and depositing it in his account, and then he would write a check to the H. and F. Truck Line to settle it, trucking and all."

The foregoing statement, made to a bank official, was false and fraudulently made with intent to deceive.

Numerous other aspects of actual fraudulent intent are reflected in the opinion and the case cannot conceivably be accepted as supporting the extreme view of the trial Judge here.

HARTFORD ACCIDENT & INDEMNITY CO. v. FEDERAL DEPOSIT INS. CORP., 204 F. 2d 933 (Eighth Circuit 1953) first cited by the trial Judge as authority for the rule he applies, is a companion case to the Altenburg Bank case, just discussed and involves the identical fraudulent scheme discussed at length in the Altenburg case. The same party who perpetrated the eleventh month kiting scheme, Schneier, was involved. Moreover, by the time the case reached the Court of Appeal any question but that there was a deliberate fraudulent scheme had dropped out of the case, because the Eighth Circuit declared: (at page 935 of 204 F.2d 933, second paragraph)

> "Two questions only are presented for review. 1. Did the loss sustained by the Brazeau Bank result from the nonpayment of a loan within the meaning of the exclusion clause of the bond? 2. Was the District Court justified in finding that the defendant's refusal to pay

> the loss was vexatious under the applicable statute of Missouri?" (Applying to penalties)

Clearly then, the above Hartford case does not support the rule for which the trial Judge contends.

The third case relied upon by the trial Judge is that of UNITED STATES v. WESTERN CONTRACTING CORPORATION, 341 F.2d 383 (Eighth Cir. 1965) comes closer to supporting the Judge's position but, upon close examination, it definitely does not do so. True, the Court, at page 389 of 341 F.2d, does find that, under a Nebraska criminal statute the bare fact that a check is dishonored or insufficient funds creates a presumption of intent to defraud. Clearly, however, this presumption is rebuttable, and the Court says so: (at page 389, last sentence)

> "' * * * the nonpayment of such checks created a rebuttable presumption of intent to defraud* * *'. We find in the record no substantial evidence to rebut the presumption."

The Court then goes on to discuss the absolute lack of any evidence tending to rebut the presumption of fraudulent intent and, among other things, notes: (at page 390, paragraph 1)

> "There was nothing approaching adequate funds in the H.K. account in the California bank at any time during the month of November to cover the $25,000.00 H.K. check deposited on

> November 5 or the $20,000.00 H.K. check deposited on November 12."

Immediately prior to the above, the Court notes a complete absence of any "arrangement with the bank for the payment of such checks." (Ruling out an expectancy that they would be honored as an overdraft by the other bank.)

Thus, completely lacking in the above case are the two factors which the trial Judge brushed aside in the instant case: (a) The fact that substantial funds "were on the way" in accounts receivable to cover the overdraft and (b) The fact that overdrafts in excess of that involved here had been frequently honored by the Dallas bank and would have been honored here but for the garnishment arising in the breach of contract suit.

The fourth case cited by the trial Judge, UNITED PACIFIC INSURANCE CO. v. IDAHO FIRST NATIONAL BANK, 378 F.2d 62 (Ninth Circuit) not only fails to support the Court's position, but, by clear implication, contradicts him in these words: (at page 66 of 378 F.2d, last paragraph)

> "* * *and it is equally evident that when the dishonored drafts were issued the company had no reasonable expectation that they would be honored upon presentment." (Emphasis added)

The emphasized language above is at war with the rule relied upon by the Judge wherein he assumes that bona fides or reasonable expectation of ability to make good are of no consequence. As noted later, the trial Judge does indeed attempt to "finesse" this point by alternatively rejecting the evidence of reasonable expectancy of ability to pay. But we are now dealing with the broad rule upon which he primarily bases his holding.

In connection with the Union Pacific case, just quoted, there is also voluminous evidence relating to actual fraudulent intent which the Court notes and makes a basis of its decision. Thus, the modus operandi in the Union Pacific Insurance case smacked of the rankest sort of fraud, as the Court observes in its resume of the facts: (at page 65, col 2, second paragraph)

> "During the period from mid-1962 until about February 22, 1963, Gem Creamery drew sight drafts several times weekly in increasing numbers, payable to various employees of the company, and gave drafts to the payee-employees with instructions to cash the drafts and return the money to the company. * * * Occasionally the payee-employee cashing the drafts represented that the drafts were drawn in payment for services performed for the company."

This sort of ring around the rosy, of course, was wholesale fraud in which everybody and his brother played a conniving part in cashing checks and giving the money to the company. So much for United Pacific,

supra. Like the other cases, it fails utterly to support the proposition contended for by the trial Judge in his first alternative rationale of liability.

Finally, we come to the last "voice crying in the wilderness" (and stating principles wholly inadequate to support the theory of the trial Judge): INDEMNITY INSURANCE COMPANY v. PIONEER VALLEY SAVINGS BANK, 8 Cir. 1965 (Eighth Cir. 1965) 343 F. 2d 634.

The opinion in this case, commencing at page 647, col. 1, last paragraph et seq. sets forth a series of deliberately fraudulent acts by the vice-president of a bank who was playing footsie with his own bank and another one in which he had an account. These fraudulent acts included such things as pointing to a portfolio he was carrying and stating, falsely, that it contained $35,000.00 to cover the checks being presented and other cold turkey lies detailed by the Court. This case, far from supporting the position of the trial Court here, actually is hostile to his theory of liability because it demonstrates how deeply one must delve into the surrounding evidence to determine whether or not there was in fact, a real scheme to defraud.

In his "Findings" filed April 10, 1970, the trial Court probably did not have the benefit of the March 16, 1970 decision of the Seventh Circuit in FIRST NATIONAL BANK OF DECATUR v. INSURANCE CO. OF NORTH AMERICA, 424 F.2d 312. There the Court, although it allowed recovery under a similar bond provision, went very deeply into the reasonableness of expectan-

cy to make good the N.S.F. checks, stating: (at page 320 of 424 F.2d 320, third paragraph)

> "The Ninth Circuit has said, quite aptly: 'The expectation of the defendant must, however, be more than mere hope. The circumstances must be such as to justify a reasonably certain belief that funds will be available (to pay the check in full when it is presented).' Williams v. United States, dupts, 278 F.2d at 537. In the instant case, when Community issued its checks to Decatur drawn on Mattoon, its financial position was, at best, supported merely by hopes. It had not been able to fulfill its contract with Levitt. All of its assets were pledged and it was indebted in the amount of approximately two million dollars beyond its encumbered assets. Talcott had been 'putting the squeeze on' since at least January. Levitt, the much relied upon hope of Community, had not fulfilled its expectations to cover its overdrafts. Finally, Community conceded that it knew a delay of one or two days in securing funds from Talcottt or Levitt 'could make a fantastic amount of difference in operations.'
>
> "In short, Community was in that state of collapse, perhaps best described as 'hopefully insolvent' where the ever-optimistic businessman hopes that all can still be salvaged if the crumbling structure can be held together for just a few days longer. This hopeful insol-

> vency normally gives way to the hopeless variety and the final efforts of the sagging enterprise most often add nothing to the estate but increased claims. When, as in the instant case, those final efforts include heavier and heavier 'kiting' of checks between banks in an attempt to meet ever increasing daily demands for ready cash, we are driven to the final conclusion that INA has failed to rebut the statutory presumption that Community had the requisite wrongful intent in issuing such checks."

In the Decatur Bank case, just quoted, the facts differ radically from those in the case at bar.

a) Here the Hughes Company, far from owing over two million dollars, as in Decatur, was apparently solvent;

b) Far from being "hopefully insolvent", as in Decatur, the Hughes Company might well have pulled out of its financial difficulty had it not been hit by a major suit for breach of contract coupled with garnishment; and

c) In the instant case, the Dallas Bank official testified that he would have honored the overdraft of $84,000.00 had it not been for the garnishment lawsuit, a financial climate entirely different from that in Decatur wherein the supporting bank had turned "cold" long before;

> d) By uncontradicted testimony Hughes Company had receivables outstanding, one for $150.00, which was overdue by an erstwhile prompt-paying customer. (App. 143)

Yet the trial Court here declines to go into any of the above facts showing good faith or reasonable expectancy of being able to pay. He seizes upon "half of the rationale" of the cited cases, i.e. the statutory presumption of fraudulent intent created by failure to make good within a certain time, but he ignores the "other half" of the rationale, namely, that it is a rebuttable presumption which requires an examination of the whole picture as to lack of fraudulent intent.

A single passage in the trial Judge's "Findings" (quoted in full context above) reveals the true rationale of his decision. At App. 480 we find the Judge stating:

> "Since it knew at the time that it did not have enough money to cover the check, the customer was deliberately using a false impression — a 'pretense' — so that it could draw on the artificial credit created at the New Orleans bank. That pretense caused the bank to sustain this loss." (Then follows the citation of the cases digested above.)

Thereafter follows the emphasized language, stating that the cited cases sustain the Court's position, namely, that the use of the N.S.F. check alone, knowing the truth, is sufficient to warrant recovery without regard

to any other factors bearing on good faith or ability to pay.

SECOND REASON: The decision below is in conflict with the better rule as to coverage of this type of policy under the "loan exclusion" clause.

The bond here provides an exclusion from coverage which was vigorously urged below. Under the heading: "Exclusions" Sec. 1(d), there is excepted from coverage:

> "Any loss the result of the complete or partial nonpayment of or default upon any loan made by or obtained from the insured, whether procured in good faith or through trick, artifice, fraud or false pretenses, except when covered by Insuring Clause (A) (D) or (E)."

This defense was sustained in a 1967 decision by a Federal District Court: CITIZENS NATIONAL BANK OF ST. PETERSBURG v. TRAVELERS INDEMNITY CO., 296 F.S. 300. There the Court declared: (at page 301, col. 1)

> "The court finds that the plaintiff failed to establish by preponderance of the evidence that it suffered any loss by larceny or false pretenses as contemplated by the Banker's Blanket Bond and that in any event, the preponderance of the evidence established that any loss which could have been suffered by Citizens was a result of the extension of credit or a loan within the meaning of exclusion (d)."

We concede that, although there are relatively few reported decisions on this "loan exclusion" defense, numerically they favor appellee. We urge strongly, however, that, aside from the basic logic involved there are factors present here which do not appear to have been considered in the cases cited by the trial Judge.[1]

Significantly, in his "Findings" the trial Judge overlooks the fact that here the requirements of his own rationale are actually present. Thus, at page 483 of the Appendix, we find the Judge, in discussing the loan exclusion, stating:

> "The policy exclusion contemplates a lending transaction knowingly entered into by the bank in reliance on the customer's express agreement to repay, most often for the purpose of making a profit on the interest."

The Court then cites a case calling for a "meeting of the minds" in order for a "loan" status to exist. What both courts overlook, however, is that there is no formal manner in which the "minds must meet" and here there was a clear cut, written form setting forth the status of a credit issued against a check which had not cleared. Thus, under cross examination by Mr. Loeb, we find witness Ward, a bank official, being ex-

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[1]In Vol. 1, page 216, we find language on the deposit slip to the effect that "provisional credit" may be granted the depositor by the bank pending clearance of the check deposited. This fact clearly provides the basis for our contention that this transaction was a "loan" hence not covered. We find no similar situation in those cases denying the "loan" theory.

amined as to the significance of a standard form on the reverse of a deposit slip whereon it is stated: (App. 776)

> "This bank expressly reserves the right to send all items for collection to its correspondents or any other bank although drawn on such bank correspondents, and all items are credited subject to payment* * *" etc. (Emphasis added)

From the above, and the testimony of Ward and other bank witnesses, it seems clear that when the N.B.C. gave instant credit to Hughes on the check which had not yet cleared, it was granting a loan or extending a credit.

The language in the case cited by the trial Judge here to the effect that a worthless check could not be deemed the basis of a loan is wholly illogical because it views the situation in the light of after-acquired knowlege. When the credit was given no one here knew the check would not be honored and the chances were excellent that it would be honored. By the testimony of the Court's own witness, Clark, the only reason the check here was not honored was the filing of the garnishment proceedings which dried up the Hughes credit from receivables.

THIRD REASON: The District Court, with no justification whatever, applied the wrong state statute in allowing attorney fees as a penalty.

Here, we submit, the award of attorney fees is clearly predicated upon the wrong statute: LSA-R.S. 9:3902 which applies only to surety bonds and does not require a showing of the nonpayment of the claim being based on conduct which can be described as "arbitrary, capricious, or without probable cause." (the language of the appropriate statute, LSA-R.S. 22:658)

The Court here sought to base its award for attorney fees solely on L.S.A.-R.S. 9:3902, which by its very terms applies only to "the surety on a bond", etc., not an insurer. The very section of the Louisiana Revised Statutes in which Sec. 9:3902 appears is Vol. 4 in Chapter 1, entitled "Suretyship" and the opening section of this chapter indicates what is intended by suretyship. Thus, Sec. 3901 provides:

> "Any executor, administrator, curator, tutor, liquidator, receiver, syndic, or other similar officer appointed or confirmed by any court * * * etc."

Other statutory forms of suretyship bonds, of course, exist but there is an obvious difference between a bond, such as one which secures the performance of a contract or fidelity by an individual and a policy of insurance which covers simply an event or contingency, irrespective of any individual. The proper statute for determining the award of penalties and attorney fees is obviously R. S. 22:658, which specifically covers:

> "All INSURERS issuing any type of contract other than those specified in R. S. 22:656 and 22:657 (life policies and accident and health policies which have different penalty provisions)." (Emphasis added)

None of the three cases cited by the Court as authority for awarding attorney fees (absent a showing of "arbitrary, capricious or without probable cause") involved insurance policies at all. They all involved statutory bonds of one form or another. Thus, BANKSTON v. NEW AMSTERDAM CASUALTY COMPANY, 17 So. 2d 332, (La. Supreme Court, 1944) involved an action on a statutory milk distributor's bond. FIDELITY HOMESTEAD ASSN. v. KENNEDY AND ANDERSON, 105 So. 64 (La. Sup. Ct. 1925) involved a suit on a contractor's bond based upon a rather old statute, Act 225 of 1918, the forerunner of LSA-R. S. 9:3902, relating to bonds given in a judicial proceeding or on a building contract, etc. (See opinion at p. 68, par. 2, col. 1)

Finally, the last case cited by the Court APEX SALES COMPANY v. ABRAHAM, 201 So. 2d 184 (La. Fourth Cir. Court of Appeal, 1967) was simply a suit on a contractor's bond and the Court, at page 187, col. 1, last par. et seq. makes very clear that the award of attorney fees is based solely on R.S. 9:3902. Not a word is said of penalties under the insurance statute, R.S. 22:658.

CONCLUSION

We respectfully submit that there are three features of this case which are of national interest and warrant the issuance of certiorari:

(a) The conflict between the decision of the Fifth Circuit and all of the other cases in the United States as to the necessity of fraudulent intent in this policy provision;

(b) In the instant case the deposit slip clearly gave the bank the option of granting "credit" by crediting the amount of the deposited check to the depositor's account before the check had cleared. It was in a very real sense a loan and the consideration was the good-will of the depositor;

(c) The District Court, in an area of substantive law, (penalties for failure to pay timely) wholly ignored the State statute and imposed its own idea of justice.

Wherefore, petitioners pray that a writ of certiorari issue to the United States Court of Appeals for the Fifth Circuit in the above case and that the judgment below be reversed and judgment be rendered in favor of petitioners, dismissing the claim of respondent.

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CERTIFICATE

I, Geo. M. Leppert, of counsel for petitioners and a member in good standing of the Bar of the Supreme Court of the United States, do hereby certify that a copy of the foregoing petition for certiorari has been served upon opposing counsel, John V. Baus, Esq., 225 Baronne St., N. O. La. by mailing same, postage prepaid and properly addressed, on April ____ 1971.

Geo. M. Leppert
Of counsel for Petitioners

APPENDIX A

OPINION BELOW
FIFTH CIRCUIT PER CURIAM

(January 29, 1971)

Before BROWN, Chief Judge, WISDOM and RONEY, Circuit Judges.

PER CURIAM: AFFIRMED. See Local Rule 21.[1] See opinion of *District Court in National Bank of Commerce in New Orleans v. Fidelity and Casualty Company of New York*, E.D. La., 1970, 312 F.Supp. 71.

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[1]See NLRB v. Amalgamated Clothing Workers of America, 5 Cir., 1970, 430 F. 2d 966.

DISTRICT COURT OPINION

RUBIN, District Judge:

I. FINDINGS OF FACT

Hughes Walsh, a contractor, had lots of bills and no money. It had accounts in a Dallas bank and a New Orleans bank, so it resorted to a classic method of robbing Peter to pay Paul: on September 10, 1968, it drew a check for $87,450 on the New Orleans bank

and deposited it in the Dallas bank. It drew a check for $87,500 on the Dallas bank and deposited it in the New Orleans bank. It thus created the illusion that it had money in both banks. Then, to pay its bills, it wrote checks against the image of solvency it had created in Dallas. The check drawn on the New Orleans bank was deposited in Dallas on September 11. The check drawn on the Dallas bank was received for deposit by the New Orleans bank on September 12.

Meanwhile the check drawn on the New Orleans bank was presented to it by the Dallas bank on September 13. This was paid because the New Orleans bank failed to discover that the check deposited with it had not yet been honored. That check had been sent to the Federal Reserve Bank in Dallas for clearance. But, as a result of an intervening weekend and other events, the New Orleans bank was not notified until September 18 that the check deposited with it had not been honored because the customer had insufficient funds on deposit in Dallas.

Thus the check kite was launched, and it flew. When Hughes Walsh wrote the check on the Dallas bank, it had an overdraft there of approximately $55,000.00; at the same time the balance in its New Orleans account was only $611.00.

The New Orleans bank had a Bankers Blanket Bond issued by the defendants and three other surety companies, who are not sued. It claims its loss was covered by clause B of that bond, which reads:

"ON PREMISES

(B) Any loss of Property through robbery, burglary, common-law or statutory larceny, theft, false pretenses, hold-up, misplacement, mysterious unexplainable disappearance damage thereto or destruction thereof, whether effected with or without violence or with or without negligence on the part of any of the Employees, and any loss of subscription, conversion, redemption or deposit privileges through the misplacement or loss of Property, while the Property is (or is supposed to be) lodged or deposited within any offices or premises located anywhere, except in an office hereinafter excluded or in the mail or with a carrier for hire, other than an armored motor vehicle company, for the purpose of transportation."

The bonding companies say this was not a loss occasioned by false pretenses because Hughes Walsh expected the Dallas bank to honor the overdraft and pay the check that had been deposited in New Orleans, or because Hughes Walsh believed it would be able to deposit funds in Dallas sufficient to cover the check before it was presented for payment. Even if Hughes Walsh did make deliberate misrepresentations to the New Orleans bank, the bonding companies contend the false pretenses were made off the bank's premises, so that the loss would be excluded from coverage under clause B. Alternatively, they urge that the transaction was in fact a loan, excluded from policy coverage.

[1] There is no evidence to support the claim that Hughes Walsh in fact acted in reliance on the assumption that the Dallas bank would honor its overdraft. That bank had done so on many occasions in the past, but Hughes Walsh had no reason to believe that it would honor the $87,500 overdraft this time, particularly since the Dallas account was already $55,000 in the red. In addition, Clifford E. Hughes, the president and principal stockholder of Hughes Walsh, testified that he signed the check deposited in New Orleans because, "We expected to get money from receivables that people owed us." Had he been confident that the Dallas bank would pay overdrafts, there would have been no reason to create the false fund in it by depositing a check drawn on the New Orleans bank: it would have been simpler and easier merely to draw the checks to pay Hughes Walsh's creditors directly on the Dallas account. Instead, as Hughes admitted, the New Orleans check was deposited in the Dallas bank for the express purpose of creating an artificial credit in the Dallas checking account.

Hence Hughes Walsh engaged in a deliberate effort to make the New Orleans bank believe that the Dallas bank would honor its check. Hughes testified that he was buying time. But he didn't pay anything for it.

I cannot credit Hughes' statement that he trusted money would be forthcoming from accounts receivable. He testified that only a garnishment, issued by a company involved in another litigation, prevented the expected payments. The only testimony to this effect is his own, and no other credible evidence sup-

ports it. I am convinced he had no sincere expectation that was defeated at the last minute by the garnishment, but rather that he was engaging in a fruitless day to day effort to gain more time.

II. CONSTRUCTION OF THE BOND

[2] The plaintiff has urged that the bond should be construed adversely to the insurers. The bonding companies say this was not a unilaterally composed document, and the rule of hostile construction should not be applied.

In fact the form of Broker's Bond involved here resulted from the joint efforts and negotiations of the American Bankers Association and the Surety Association of America. There is no need to apply any rule of construction applicable only to ambiguities because the language of the bond is clear. It need be read with neither favoritism to one party nor severity toward the other.

III. DID THE LOSS RESULT FROM FALSE PRETENSES?

[3] The bond covers any loss through "false pretenses." This phrase has been interpreted by the courts as including losses sustained by a bank through check kiting. By presenting the check to the New Orleans bank, the customer represented that it was drawn against an account with sufficient funds. Since it knew at the time that it did not have enough money to cover

the check, the customer was deliberately using a false impression — a "pretense" — so that it could draw on the artificial credit created in the New Orleans bank. That pretense caused the bank to sustain this loss. See Hartford Accident and Indemnity Co. v. Federal Deposit Insurance Corp., 8 Cir. 1953, 204 F.2d 933; Fidelity and Casualty Company v. Bank of Altenburg, 8 Cir. 1954, 216 F.2d 294; United States for use of First Continental National Bank & Trust Co., Lincoln, Nebraska v. Western Contracting Corporation, 8 Cir. 1965, 341 F.2d 383; United Pacific Insurance Co. v. Idaho First National Bank, 9 Cir. 1967, 378 F.2d 62; Indemnity Insurance Co. of North America v. Pioneer Valley Savings Bank, 8 Cir. 1965, 343 F.2d 634.

It is argued that these cases are so distinguishable on their facts from the case at bar that their holdings are irrelevant. This is to insist that to apply *Palsgraf* we must find scales in a depot. In all the cases the courts found that obtaining funds or credit from banks through the knowing circulation of worthless checks amounted to "false pretenses," and that the banks' resultant losses were covered by the Bankers' Blanket Bond. Although the details of the check kiting operations vary from case to case, the logic of the opinions is both pertinent and persuasive. See also Liberty Nat. Bank & Trust Co. v. Travelers Indemnity Co., 1968, 58 Misc.2d 443, 295 N.Y.S.2d 983, and Annotation (1951), Insurance of bank against larceny and false pretenses, 15 A.L.R.2d 1006.

This diversity case turns on Louisiana law. But the principles appear to be no different from those of Mis-

souri, as applied by the Eighth Circuit in Fidelity and Casualty Company v. Bank of Altenburg, *supra:*

> "Check kiting, as practiced here, involves more than the mere use of the check with insufficient funds in the bank to meet it. It involves a series of acts which together constitute a scheme, a studied device, false pretenses built upon a series of false representations designed to lull the banks involved into a feeling of confidence and security. The bad check is given. Money or credit is received from a bank other than the one on which the check is drawn. If credit is taken, that credit is usually drawn upon immediately. The check kiter then deposits a check in the bank upon which the first check is drawn before the first check arrives there. The second check is drawn on the bank from which the first money or credit is received. Credit is taken from it and that credit covers the first check when it comes in and possibly additional credit." 216 F.2d at 302.

Louisiana's criminal law prohibits the knowing issuance of worthless checks. LSA-R.S. 14:71. The statute creates a presumption that intent to defraud exists when the offender fails to pay a check within 10 days after he has been notified of its nonpayment. This is, of course, rebuttable. Blue Bonnet Creamery, Inc. v. Gulf Milk Association, La. App. 1965, 172 So.2d 133. It is inappropriate to discuss here whether a violation of Louisiana's criminal law has occurred; but it

is clear that the issuance of checks knowing they are worthless is in general condemned by Louisiana law.

Nor was Hughes himself an innocent lamb who guilelessly signed checks that turned out unhappily but unintentionally to be worthless. While he was getting the Dallas-New Orleans kite up in the air, he was also flying one between a bank in Baton Rouge and the same Dallas bank involved in the exchange of checks that caused the loss in this case.

"The bond does not define the term 'false pretenses,'" the court said in United States v. Western Contracting Corporation, *supra*. But, as it continued, "It seems clear that the coverage of an item such as false pretenses is at least as broad as the criminal definition of the term."

For these reasons, the conduct of Hughes Walsh with respect to the New Orleans bank is held to constitute "false pretenses," as that phrase is used in the bond.

IV. THE "LOAN" EXCLUSION IS NOT APPLICABLE TO A CHECK KITING SCHEME

[4] The argument that the New Orleans bank was making a loan when it honored the check drawn on it, and hence that the bond doesn't cover its loss, will not bear analysis. Certainly Hughes Walsh owes the bank money. But the New Orleans bank can no more be said to have made a loan to him than it could be said to lend money to an embezzler. The policy exclu-

sion contemplates a lending transaction knowingly entered into by the bank in reliance on the customer's express agreement to repay, most often for the purpose of making a profit on the interest.

In National Bank of Paulding v. Fidelity & Casualty Co., S.D. Ohio 1954, 131 F.Supp. 121, the bank had sustained losses because of its reliance on fictitious documents. Rejecting the argument that the funds had been advanced as a "loan," the court noted that a loan is a consensual contract whereby one person advances money to another and the other agrees to repay it upon certain terms as to time and rate of interest, and that, in order to have a contract of this type, "There must be a meeting of minds," 131 F.Supp. at 123-124.

We agree with the court in Hartford Acc. & Indem. Co. v. Federal Deposit Ins. Co., *supra,* 204 F.2d at 937, that "It is not conceivable * * * that any disinterested banker, insurance underwriter, or lawyer would construe the word 'loan' as used in the exclusion clause of this indemnity bond, to cover the obligation imposed by law to reimburse a bank for money or credit obtained through the use of worthless checks."

In that case losses from a check kite were held to have resulted from "false pretenses" rather than from a bad loan. The court stated:

> "Contracts of insurance, like other contracts, must be construed according to the terms which the parties have used, to be taken and understood, in the absence of ambiguity, in

> their plain, ordinary, and popular sense." 204 F.2d at 937.

In its "plain, ordinary and popular sense," and as it has consistently been interpreted in the context of the Bankers' Blanket Bond, the word "loan" does not include money advanced in good faith on worthless checks.

See also, for cases specifically holding that credit advanced on kited checks is not a loan, Fidelity & Casualty Co. v. Bank of Altenburg, *supra;* United States v. Western Contracting Corp., *supra;* United Pacific Ins. Co. v. Idaho First Nat'l Bank, *supra;* Pioneer Valley Savings Bank v. Indemnity Ins. Co. of North America, *supra.*

V. DID THE LOSS OCCUR OFF THE PREMISES?

[5] Clause B of the bond covers losses of property only "while the Property is (or is supposed to be) lodged or deposited within any offices or premises. * * *" It would be meaningless, in our credit economy, to debate the question of where the actual *money* represented by a bank's check is located, and defendant does not argue that the "property" lost when Hughes Walsh's checks turned out to be worthless was off the premises when the loss occurred.

Defendant maintains, however, that because clause B is entitled "ON PREMISES," all of the items mentioned therein must have occurred on the premises

of the insured in order to be covered; it then contends that any "false pretenses" involved in the instant transactions were made off the premises, and that the losses are therefore not recoverable. Even assuming the "on premises" requirement does apply to "false pretenses" as well as to "property," the argument that the misrepresentation of the solvency of Hughes Walsh's Dallas account was not made at the New Orleans bank is fanciful.

Hughes mailed a deposit from Dallas to the New Orleans bank. He intended the New Orleans bank to believe the check was good when the New Orleans bank received it, and his expectation was borne out. The act of depositing it in New Orleans constituted a false representation there. See Fidelity and Casualty Company v. Bank of Altenburg, *supra*. The loss occurred on the bank's premises in New Orleans.

VI. PENALTIES AND ATTORNEY'S FEES

[6] Plaintiff requests the penalties prescribed by LSA-R.S. 22:658 be imposed on defendant for its allegedly unreasonable failure to pay plaintiff's claim within 60 days after receipt of proof of loss. However, it has not been established that defendant's refusal to pay was, in the words of the statute, "arbitrary, capricious, or without probable cause." Although defendant's interpretation of the bond coverage had been rejected by a number of courts, it was not wholly unrealistic or frivolous. Moreover, on the facts, there was at least superficial logic to Hughes' explanation. Al-

though I do not credit it, the bonding company was not whimsical in doing so, particularly since it had not had the benefit of a full adversary hearing before it had to decide whether to accept Hughes' version of the events. Hence, the claim for penalty fees is rejected.

[7] But in addition to the penalty imposed by LSA-R.S. 22:658, LSA-R.S. 9:3902 provides:

> "If the surety on a bond fails to pay his obligation and it becomes necessary for the creditor to sue thereon, the latter shall be entitled to ten per cent attorney's fees on the amount recovered, provided he has employed an attorney for the purpose, has made written amicable demand on the principal and surety and thirty days have elapsed from their receipt thereof without payment being made, and the full amount claimed in the demand is recovered."

The words of this statute are both unconditional and mandatory. More than 30 days have elapsed since defendants have received plaintiff's written demand for payment of its claim. When payment was not made by defendants it became necessary for plaintiff to employ an attorney for the purpose of enforcing its claim. I have granted judgment for the full amount claimed. As a result, plaintiff is entitled to ten percent of the amount recovered as attorney's fees. See Bankston v. Loranger Milk Plant, 1944, 205 La. 290, 17 So.2d 332; Fidelity Homestead Assn. v. Kennedy & Anderson,

1925, 158 La. 1059, 105 So. 64; Apex Sales Co. v. Abraham, La. App. 1967, 201 So.2d 184.

CONCLUSION

Accordingly the Clerk will enter judgment for the plaintiff:

against the defendant, Fidelity & Casualty Company of New York, in the sum of $17,618.35, plus 10% additional as attorney's fees, plus legal interest from November 15, 1968;

against the defendant, The Travelers Indemnity Company, in the sum of $11,745.57, plus 10% additional as attorney's fees, plus legal interest from November 15, 1968;

against the defendant, Firemen's Fund Insurance Company, in the sum of $11,745.57, plus 10% additional as attorney's fees, plus legal interest from November 15, 1968.

There shall be judgment over, in favor of the defendants Fidelity & Casualty, Travelers, and Firemen's Fund, on their cross-claim against Hughes Walsh, Inc. and Clifford E. Hughes, defendants-intervenors.

APPENDIX B

LOUISIANA REVISED STATUTE R.S. 22:658

§ 658. Payment of claims, policies other than life and health and accident; penalties

All insurers issuing any type of contract other than those specified in R.S. 22:656 and 22:657 shall pay the amount of any claim due any insured including any employee under Chapter 10 of Title 23 of the Revised Statutes of 1950 within sixty days after receipt of satisfactory proofs of loss from the insured, employee or any party in interest. Failure to make such payment within sixty days after receipt of such proofs and demand therefor, when such failure is found to be arbitrary, capricious, or without probable cause, shall subject the insurer to a penalty, in addition to the amount of the loss, of 12% damages on the total amount of the loss, payable to the insured, or to any of said employees, together with all reasonable attorney's fees for the prosecution and collection of such loss, or in the event a partial payment or tender has been made, 12% of the difference between the amount paid or tendered and the amount found to be due and all reasonable attorney's fees for the prosecution and collection of such amount. Provided, that all losses on policies covering automobiles, trucks, motor propelled vehicles and other property against fire and theft, the amount of the penalty in each of the above cases shall be 25% and all reasonable attorney's fees. Amended and reenacted Acts 1958, No. 125.